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COMMONWEALTH OF MASSACHUSETTS
BEFORE THE
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

	)	
Petition of Western Massachusetts Electric Co.	)	
for approval of its Transition Charge Reconciliation	)	D.T.E. 00-33
filing for the period March 1, 1998 through	)	
December 31, 1999.	)	
	)	

INITIAL BRIEF OF
WESTERN MASSACHUSETTS ELECTRIC COMPANY

I. INTRODUCTION

On March 31, 2000, Western Massachusetts Electric Company (?WMECO? or ?Company?) submitted to the Department of Telecommunications and Energy (?Department?) its Transition Charge Reconciliation filing for the period March 1, 1998 to December 31, 1999, including the pre-filed direct testimony of Robert A. Baumann (Exh. WM-1).[1]

The Electric Industry Restructuring Act, Chapter 164 of the Acts of 1997, provided for the recovery of Transition Costs (*see* G.L. c. 164, ?? 1A, 1B and 1G) and it also provided that the Department will ?audit, review and reconcile the difference between projected transition costs and actual transition costs? of an electric company every 18 months after the Department has approved a restructuring plan for the electric company (G.L. c. 164, ? 1A).

The Department reviewed WMECO?s restructuring plan in meticulous detail over the course of two years in D.T.E. 97-120. Twenty-nine evidentiary hearings were held between September 28, 1998 and November 23, 1999 in which eleven witnesses testified for

WMECO, five witnesses testified for the Attorney General and two testified for the Division of Energy Resources. The Department issued its 196 page Order on WMECO?s restructuring plan in D.T.E. 97-120 on September 17, 1999. Subsequently, on December 1, 1999, the Department disposed of the Attorney General?s and Western Massachusetts Industrial Customer Group?s motions for clarification and reconsideration, and, in an Order issued December 20, 1999, approved WMECO?s D.T.E. 97-120 compliance filing.

This proceeding, D.T.E. 00-33, deals with only the ?true-up? or ?reconciliation? of Transition Costs for the period March 1, 1998 through December 31, 1999 that have not previously been resolved through settlement (as indicated in Section II, below, a portion of the D.T.E. 00-33 proceeding has been settled). WMECO has subsequently filed, on March 30, 2001, its Transition Charge Reconciliation filing for calendar year 2000. That filing is not the subject of this proceeding.

II. PROCEDURAL HISTORY

On July 11, 2000 the Department noticed this proceeding and the Attorney General was the only party to intervene. At the time this proceeding was noticed, WMECO and the Attorney General had entered into a June 30, 2000 partial settlement in this matter (as well as settling in their entirety D.T.E. 97-120 (Phase 2), D.P.U. 96-8C-1, D.P.U. 97-8C-1, D.T.E. 98-8C-1 and D.T.E. 99-8C-1). The June 30, 2000 partial settlement provided that:

> All matters or issues with respect to the assignment of specific wholesale contracts from WMECo to Select Energy, Inc., which assignments were accepted to filing with the FERC on December 29, 1999, in Docket No. ER00-102, and which are now before the Department in D.T.E. 00-33, are terminated and no longer before the Department and may not be raised in any present or future Department proceeding, including WMECo restructuring plan reconciliation proceedings.

The June 30, 2000 partial settlement also provided that WMECO?s request for an inflation adjustment for the period March 1999 through August 1999 was terminated.

On August 4, 2000, the Department approved the settlement proposed by WMECO and the Attorney General, including the partial settlement in D.T.E. 00-33. Accordingly, the issues relating to the assignment of wholesale contracts to Select Energy, Inc. and the inflation adjustment for March to August 1999 are settled and no longer before the Department in this proceeding.

On October 1, 2000, WMECO submitted a filing amendment in D.T.E. 00-33 reflecting the Department?s August 4, 2000 settlement approval (Exh. WM-3). Given the amendment to the filing, the Department re-noticed this proceeding on October 31, 2000. No additional parties sought to intervene.

On January 19, 2001, WMECO submitted the pre-filed testimony of John P. Stack (Exh. WM-4). Mr. Stack is the Executive Director of Corporate Accounting and Taxes for NU, including WMECO. The prefiled rebuttal testimony of Messrs. Baumann and Stack were filed on March 16, 2001 (Exhibits WM-5 and WM-6, respectively). Attorney General witness David J. Effron submitted prefiled direct on January 24, 2001 and surrebuttal testimony on April 13, 2001.

Evidentiary hearings in this proceeding were held on May 1-3, 2001. Entered into evidence at the conclusion of hearings were WMECO exhibits WM-1 through WM-6 and Attorney General exhibits AG-1 through AG-3. In addition, data responses were admitted into evidence. Entered were WMECO?s responses to five sets of data requests from the Attorney General (AG-1-1 to 1-36, AG-2-1 to 2-37, AG-3-1 to 10, AG-4-1 to 4-2 and AG-5-1 to 5-

18) and one set from the Department (DTE 1-1 to 1-24). Also entered were Attorney General responses to WM-1-1 through 1-43, WM-2-1 through 2-12 and DTE-1-1 through 1-4. Finally, the Department and the parties issued 16 record requests at evidentiary hearings, which have been responded to and are now part of the record.

III. STANDARD OF REVIEW

Under G.L. c. 164, ? 1A, a reconciliation proceeding is not an *ab initio* review of an electric company?s restructuring plan. Nor is a reconciliation proceeding intended to provide adverse parties an opportunity to relitigate transition costs already approved by the Department for recovery in a restructuring plan order. In addition, it is not intended to provide adverse parties an opportunity to raise new transition cost issues not previously raised in the restructuring plan proceeding. Rather, the object of a reconciliation proceeding is the more limited one of a ?true-up? of projected versus actual transition costs. General Laws c. 164, ? 1A, states this succinctly when it mandates that the scope of a reconciliation proceeding is to ?audit, review and reconcile the difference between projected transition costs and actual transition costs.?

The Department?s rules support the limited nature of its reconciliation review. Under 220 CMR 11.03(4)(e), the Department?s review of reconciliation proceedings is to be conducted only pursuant to the language cited above in G.L. c. 164, ? 1A, and pursuant to G.L. c. 164, ? 1G(a)(2). Section 1G(a)(2) provides that ?[s]uch review shall be limited to a comparison of assumed costs and assumed mitigation to the actual costs determined through actual mitigation.? The Department has further recognized the limited scope of reconciliation proceedings by stating that a Department review is intended to ?ensure that the **proposed reconciliations** are consistent with or substantially comply with? the statutes, restructuring plan and Department precedent (emphasis supplied). *Boston Edison Company*, D.T.E. 98-111 (October 19, 1999), p. 4.

The limited scope of a reconciliation proceeding is particularly appropriate for a review of WMECO?s reconciliation proceeding because the reconciliation proceeding is merely a follow-up to WMECO?s fully-contested restructuring proceeding, D.T.E. 97-120, in which all parties had an opportunity to raise and explore the universe of restructuring issues. In fact, as indicated above, in D.T.E. 97-120 adverse parties did raise and contest, to an unprecedented degree, an enormous number of restructuring issues. The Department decided each issue after careful deliberation.

Contrary to the restructuring law, and without providing any reference to the applicable statutory or regulatory provisions governing the scope of reconciliation proceedings, the Attorney General urges the Department to adopt a wildly expansive and improper standard of review in this proceeding (Attorney General Brief, p. 3). This improper standard of review, reserved for a restructuring plan review under the subsections of G.L. c. 164, ? 1G, would require a relitigation of the transition cost issues finalized in D.T.E. 97-120. The Attorney General would have the Department identify all over again ?those costs and categories of costs for generation-related assets, investments and obligations?which may be allowed to be recovered through a non-bypassable transition charge?? (Attorney General Brief, p. 3). Such a standard is completely at odds with the established scope of a reconciliation proceeding as set forth above. While the Attorney General may need such a broad, improper standard of review in this proceeding in order to boot-strap many of his arguments, that does not justify such a standard.[2] In order to follow the mandate of the Legislature, the Department?s own rules and, importantly, the need to avoid the constant relitigation of restructuring plans in successive reconciliation proceedings, the Department must recognize and enforce the limited scope of review of this reconciliation proceeding.

IV. WHEN WARRANTED, WMECO ON ITS OWN INITIATIVE HAS ACKNOWLEDGED CORRECTIONS TO ITS RECONCILIATION CALCULATIONS AND ACCEPTED CORRECTIONS FROM THE ATTORNEY GENERAL.

In any proceeding with the computational complexity of this one, it is likely, if not inevitable, that certain miscalculations will occur. WMECO has not hesitated to admit when legitimate computational errors have been made and make appropriate changes to the Company?s filing. At hearings, Mr. Baumann identified seven corrections to the filing as revised on October 1, 2000.

(1) In its compliance filing, WMECO will use the actual 1998 and 1999 capital structure in the rate of return calculation rather than the 1995 capital structure. As explained on Exh. AG-IR-1-35 and Exh. AG-3-38, the revised capital structure will decrease WMECO transition costs by approximately $650.000. Tr. 1, p. 11.

(1) In its compliance filing, WMECO will revise a Financial Accounting Standards (?FAS?) 106 credit relating to the sale of fossil/hydro generation in 1999. As set forth in Exh. AG-IR-2-6, transition costs should be decreased by $39,901 (the difference between $59,901 and $20,000) due to a misreading of a document provided by WMECO?s actuaries. Tr. 1., p. 11.

(2) In its compliance filing, WMECO will correct an error that it discovered relating to the proceeds from the 1999 fossil/hydro divestiture. The correction means that the proceeds from the sale will increase by $90,000 (*i.e.*, there will be a net decrease to transition costs of $90,000). Exh. AG-IR-1-21 (Workpaper G); Tr. 1, p. 11.

(3) In its compliance filing, WMECO will adjust downward its FAS 106 regulatory asset to reflect the balance on March 1, 1998 instead of December 31, 1997. The use of the March 1, 1998 date will reduce the balance, and therefore reduce transition costs downward over time by approximately $114,000. Exh. AG-IR-2-31, Tr. 1, p. 12.

(4) In its compliance filing, WMECO will remove $4,173,000 of unrecovered fuel cost from its calculation of transition costs. This is a timing issue because the settlement approved by the Department on August 4, 2000 in D.T.E. 97-120 (Phase 2) *et al.* approves the Company?s collection of this amount. However, as set forth in the settlement, the $4,173,000 will be collected in the reconciliation proceeding filed in March 2001. Tr. 1, p. 12; Exh. AG-IR-1-37.

(5) In its compliance filing, WMECO will reflect a reduction to take into account a double counting of the **recovery** portion of the FAS 106 asset. (There is no double counting of the **return** portion relating to FAS 106.) The reduction due to the double collection is $1,248,000. Tr. 1, p. 13. However, as Mr. Baumann stated, the double counting exists only in the event that the level of WMECO?s FAS 106 recovery is approved; should a different method be approved the double recovery could be eliminated. Tr. 3, p. 299.

(6) In its compliance filing, WMECO will recalculate all schedules to remove the impact of the originally-filed $5.778 million inflation adjustment. As indicated in Section II, above, WMECO agreed to forego recovery for the inflation adjustment as part of the settlement approved by the Department in D.T.E. 97-120 (Phase 2) *et al*. At hearings, Mr. Baumann testified that although WMECO?s filing was changed to remove the $5.778 million from the net proceeds of the sale of the fossil/hydro generating facilities, there were secondary effects of the removal that were not reflected. *See, e.g.*, Tr. 1, p. 21, lines 18-21. The compliance filing will reflect the removal of the $5.778 million on all schedules. Tr. 2, p. 135.

(7) In addition to the changes identified by Mr. Baumann, WMECO will correct in its compliance filing an error it identified with respect to Tariff 7 (or T-7) Off-System transactions. True T-7 Off-System transactions have no connection to WMECO?s system or customers and neither the costs nor the revenues should be recovered from WMECO?s customers. However, WMECO, on its own initiative, identified $791,110 in revenues that were mistakenly categorized as T-7 Off-System transactions and instead should be credited to customers. Accordingly, WMECO?S compliance filing will show a reduction of $791,110 for this item. *See* Exh. DTE-RR-13.

V. WMECO HAS FULLY COMPLIED WITH THE DEPARTMENT?S DIRECTIVE IN D.T.E. 97-120 PERTAINING TO RECONCILIATION OF FAS 106 BALANCES; THE ATTORNEY GENERAL?S PROPOSAL IS CONTRARY TO WHAT HE PROPOSED IN D.T.E., 97-120, CONTRARY TO ACTUARIAL STANDARDS, AND WOULD CAUSE NUMEROUS PROBLEMS.

A. THE FAS 106 OBLIGATION AND THE DEPARTMENT?S D.T.E. 97-120 ORDER ARE CLEAR.

The Department considered the issue of FAS 106, post-retirement benefits other than pension benefits, in D.T.E. 97-120. (This category of benefits pertains to medical and life insurance benefits owed to vested employees.) In its decision in that proceeding the Department explained the genesis of the issue. D.T.E. 97-120, pp. 62-64. The Department stated that effective January 1, 1993 WMECO was required by generally accepted accounting principles (?GAAP?) to change its financial book accounting method from the cash to the accrual basis for FAS 106. At the time of adoption, FAS 106 required that the obligation for future benefits already earned by current retirees and employees with past service (the ?Transition Obligation?) be recognized and amortized over not more than 20 years. D.T.E. 97-120, p. 64.

Therefore, on January 1, 1993, WMECO recognized an obligation (what has been defined above as the Transition Obligation) at a level determined by the Company?s actuaries. Tr. 1, p. 46. The Transition Obligation refers only to that obligation existing on January 1, 1993, which WMECO is expensing over 20 years. Tr. 1, p. 46. As of 1993, eighty-three percent of those eligible for FAS 106 post-retirement benefits were retired employees. Therefore, the Transition Obligation largely reflects future payments to those retired employees.

In D.T.E. 97-120, because the vertically integrated utility structure was being disaggregated and a portion of costs relating to generation were to be collected through the Transition Charge, WMECO allocated a portion of the Transition Obligation to generation. D.T.E. 97-120, p. 64. The Department approved this allocation. D.T.E. 97-120, p. 66.

In D.T.E. 97-120, the Attorney General proposed that the FAS 106 Transition Obligation be modified in any reconciliation proceeding to include the effect ?**of any actuarial gains or losses associated with the [FAS 106] obligation, as of the time of each divestiture**? (emphasis supplied). The Attorney General further asserted that there were ?**changes to actuarial assumptions**? related to certain factors that should be incorporated (emphasis supplied). D.T.E. 97-120, p. 65. The Attorney General also wanted the Transition obligation to reflect ?**actuarial** gains and losses? (emphasis supplied). Id. The Company agreed that it would reconcile the FAS 106 balances based on ?**information available from its actuaries**? (emphasis supplied). *Id.*

The Department?s decision in D.T.E. 97-120 adopted the position of the Attorney General and WMECO that FAS 106 balances should be ?derived from an ?**actuarial study**? (emphasis supplied) (p. 66). The importance of basing the FAS 106 obligation on an actuarial study is set forth in the Department?s Order. The Department stated that there is a potential for significant swings in the real cost of the FAS 106 obligation because medical costs, inflation and discount and investment rates are not known with any certainty in advance. *Id*. The Department notes that the ?Actuarial Standards Board has stated that the characteristics inherent in the FAS calculation assure substantial variation between expected and actual results? and therefore it is important that the determination of the FAS 106 benefit obligations ?**should**

include the effect of actuarial gains and losses? (emphasis supplied). *Id.*

The Department explained how it wants FAS 106 treated and, as shown below, WMECO has complied with this treatment in its filing.

B. WMECO HAS COMPLIED WITH THE DEPARTMENT?S ORDER IN D.T.E. 97-120 BY UPDATING THE FAS 106 OBLIGATION BASED ON AN ACTUARIAL STUDY OF GAINS AND LOSSES.

In this proceeding, WMECO has done exactly as instructed in D.T.E. 97-120. It has relied on the respected actuarial firm Towers Perrin to calculate the change in the FAS 106 benefit obligation updated as of the date of the sale of fossil/hydro facilities to CEEMI on July 23, 1999. Exh. AG-1-5, p. 2.

Mr. Stack testified that he was in close contact with the actuaries, and he fully explained the process by which the actuaries determined the adjustment to the FAS 106 calculation. Tr. 2, pp. 176-179. First, Mr. Stack stated that there is the change to the accumulated post-retirement benefit obligation (?APBO?) to consider. There are two pieces to this. The initial change is that some employees leave the Company sooner than anticipated and receive benefits sooner than the actuaries originally anticipated. This factor causes the APBO to increase (*i.e.*, it is an increased cost to WMECO). The offsetting factor is that there are employees that leave the Company who are not vested in post-retirement benefits and that causes the APBO to decrease (*i.e.*, a decreased cost to WMECO). Tr. 2, pp. 176-177. When these two pieces are put together the gain (or decreased cost to the Company) is $166,073 (the $213,413 APBO in Column 3 minus the $47,370 in Column 4) (Exh. AG-IR-2-6, p. 3).

Second, there is an acceleration of the Transition Obligation, which is an expense (an added cost to the Company). Rather than amortizing a certain amount over 20 years, it had to be recognized immediately because certain employees left the Company. Tr. 2, p. 178. This amount is $152,452. Exh. AG-IR-2-6, p. 3.

Third, there is one piece to the Company?s calculation that overstates the benefit to the Company (*i.e.*, reflects a reduction in FAS 106 costs) by recognizing a benefit that does not really exist and that is inconsistent with accounting rules. Tr. 2, p. 178. That pertains to the one employee that was vested in the Company?s post-retirement plan that left the Company to work with CEEMI. The fact that the employee went to work with CEEMI has no impact on WMECO?s Transition Obligation or the benefits earned by the employee since 1993 (*i.e.*, WMECO remains responsible for paying this individual?s post-retirement benefits). Tr. 2, p. 189. However, WMECO determined that it would treat the employee?s departure as if it was a ?settlement?; that is, treat it as if WMECO did not have any future obligation to this employee.[3] Tr. 2, pp. 184, 191. This is not a settlement under GAAP accounting and therefore recording of unrecognized gains should not take place, but it was left in the Company?s filing because it is not a material amount and the Company is not formally requesting to eliminate it at this time.[1] Tr. 2, pp. 174, 186. The adjustment for the departed employee amounts to $46,310. Exh. AG-IR-2-6, p. 3.

Accordingly, the actuaries, putting together the factors shown above ($166,043 minus $152,452 plus $46,310) show a FAS 106 gain (which translates into a reduction of transition costs) of $59,901. *Id.* This is the net change in FAS 106, as determined by Towers Perrin, and the amount the Department should approve as the FAS 106 adjustment in this proceeding.

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[1] However, Mr. Stack testified that ?[a]s we get further on and we?ve got more employees leaving the plan, like with the Millstone sale, that will be material? and WMECO will not be able to continue to reflect the elimination of costs that are not truly eliminated. Tr. 2, p. 186.

Any other adjustment should be rejected as contrary to the true costs that WMECO continues to bear with respect to FAS 106.

C. THE ATTORNEY GENERAL?S FAS 106 PROPOSAL IS FATALLY FLAWED.

There are a number of reasons that the Attorney General?s proposal is flawed but as an initial matter it must be emphasized that the Attorney General has not even followed its own proposal in D.T.E. 97-120. There he agreed that any reconciliation should be based on actuarial gains or losses and actuarial inputs. D.T.E. 97-120, p. 65; *see* Subsection A, above. The Attorney General?s proposal must be rejected for that reason and the reasons set forth below.

1. The Attorney General?s Plan Fails To Comply With The Department?s Order.

First, the Attorney General?s proposal must be rejected because it does not comply with the Department?s requirement that any new FAS 106 balance take into account ?actuarial assumptions related to cost escalation rates, discount rates, and other inputs to the determination of the FAS 106 benefit obligation.? D.T.E. 97-120, p. 66. Mr. Effron is not an actuary or familiar with the most basic actuarial principles and has made no attempt to take into account the actuarial inputs required by the Department. Tr. 2, pp. 206, 240.

2. The Attorney General?s Plan Improperly Raids WMECO?s FAS 106 Fund, Causing Numerous Problems Including The Volatility The Department Found Must Be Avoided.

Consistent with his disregard for actuarial principles and the Department?s principles, Mr. Effron seeks to take a major portion of WMECO?s FAS 106 ?unrecognized net gain? to effect an immediate short-term credit to the FAS 106 obligation. Exh. AG-1, pp. 12-13; *see,* *also,* Subsection 3, below.

This method, however, fails to follow actuarial rules for computing the FAS 106 balance, thus violating the Department?s stated interest in avoiding volatility. D.T.E. 97-120, p. 66. Just because there is an unrecognized gain today does not mean that the value of the fund will not drop tomorrow, wiping out that unrecognized gain. In addition, just because the investment gains were much better than expected in the years leading up to 1999 does not mean they will not be much less than expected in subsequent years. Tr. 2, pp. 179-180, 190-191. Actuaries are employed in this area to help ensure that there are sufficient amounts in the fund to account for these fluctuations.

Importantly, one effect of siphoning off millions of dollars from the unrecognized gain in an actuarially improper fashion is that it almost certainly means at some point rates will have to be increased in order to collect back those millions. In other words, the FAS 106 obligation is subject to much more volatility when improper reductions are made because counterbalancing drastic future adjustments will need to be made to restore the fund to its proper level (that is, restore it to the level needed to pay the obligations associated with the post-retirement benefits). Tr. 2, p. 191. The Department has stated in no uncertain terms that volatility is to be avoided and for this reason the Attorney General?s raid on WMECO?s FAS 106 unrecognized gain must be rejected.

A closely-related problem with the Attorney General?s raid is that it assumes that a significant level of costs have vanished, when that simply is not the case. FAS 106 costs remain, as calculated by the Company?s actuaries. Apart from the $59,901 identified by

WMECO, the Company has all the same costs that it had prior to the Towers Perrin?s actuarial reevaluation. That is, apart from the $59,901, WMECO has all the same financial obligations to its active and retired employees that it did previously.

3. There Is No Underlying Rationale To Support The Superficial ?Consistency? Of Using The Percentage Allocation To Generation To Calculate A Customer Credit.

The Attorney General attempts to cover over the fundamental errors he has already made by suggesting that all he is doing is allocating the unrecognized gain in the same percentage as the Company did when it allocated the Transition Obligation to generation in the restructuring plan proceeding. Exh. AG-1, p. 12. The Attorney General is mistaken in his use of the allocation percentage.

Pursuant to restructuring, there was a need to disaggregate costs that had previously been aggregated, and the Company arrived at a certain allocation based on a count of then-current employees engaged in generation compared with the total number of employees. Tr. 2, p. 175. This allocation did not change the amount that needed to be collected pursuant to the Transition Obligation, it merely broke it into two pieces. A portion was to be collected from distribution and a portion from generation. As the costs associated with FAS 106 are incurred they are reflected in the Company?s accounts. The correct way to do this is to reflect real eliminated costs (*i.e.*, costs that actuaries agree are avoided) from the distribution and generation portions. It is improper to assume, as the Attorney General has done, that the FAS 106 unrecognized gain can be immediately credited to customers without any evidence that any costs have been eliminated. Ultimately, the FAS 106 costs in their entirety have to be collected and the collection should proceed based on an actuarial determination of the costs. Tr. 2, p. 188, 192. The Attorney General?s position on the allocation of the unrecognized gain to the Transition Charge fails this test.

With respect to the relationship between generation and distribution rates, Mr. Effron?s proposal also fails to recognize the need to avoid cost-shifting between distribution-collected Transition Obligation and generation (Transition Charge)-collected Transition Obligation. The FAS 106 costs have to be collected at some point from WMECO?s customers, either through distribution or generation rates and the Department approved an allocation between distribution and generation in D.T.E. 97-120. Tr. 2, p. 188. To the extent collection is diminished or eliminated from the generation component, it will have to be collected from the distribution component, thus violating the allocation approved by the Department. In order to avoid cost-shifting, the approximately one-fourth of the Transition Obligation being collected through generation-related rates should be based on the same actuarially sound basis as the approximately three-quarters of the Transition Obligation that is being collected through distribution rates. Tr. 2, p. 188.

4. The Attorney General?s ?Method? Is Not Consistent With Accounting Rules, And This Inconsistency Will Harm WMECO And Its Customers.

In addition to its other difficulties, Mr. Effron?s proposal is inconsistent with accounting rules because it attempts to capture immediately the unrecognized gain. Reducing the Transition Obligation in this way violates accounting rules because accounting rules require a match between obligations and expenses. Tr. 2, p. 179. When there is a mismatch, as there would be here, the Company would have to take the significant step of reflecting a write-off, which would harm the Company financially. Tr. 2, p. 179; Tr. 3, p. 315. As Mr. Stack testified, ?If we were directed to follow a method that would result in significantly different pension or post-retirement benefit expense? we would have a write-off, which would present a problem for WMECo as it relates? to investors, and the rippling effects that would cause?. Tr. 3, p. 315. Accordingly, not only is the Attorney General?s proposal improper, it would cause financial problems for WMECO, and through the ?rippling effect?, problems for WMECO?s customers.

D. THE ATTORNEY GENERAL?S BRIEF SHEDS NO LIGHT ON THE FAS 106 ISSUE

The Attorney General?s Brief sheds no light on the proper treatment of the Transition Obligation and merely repeats in a somewhat disjointed fashion the points that have been addressed above. While the points in the Attorney General?s Brief have been covered in subsections B and C, above, WMECO will respond to two assertions that are particularly lacking in support.[4]

First, the Attorney General claims that actuarial studies show the ?original estimate? of FAS 106 obligation to be overstated. Attorney General Brief, p. 9. There is no explanation of what the ?original estimate? means. WMECO has submitted the only actuarial study in this proceeding and it does not show the ?original estimate?, whatever that is, to be overstated. Exh. AG-IR-1-5. Moreover, it is improper for the Attorney General to try to cite WMECO?s actuarial report for his position, when his witnesses? proposal is the complete antithesis of any actuarial analysis. However, WMECO is happy to have the Attorney General agree that the actuarial study is important to this issue. The report completely supports WMECO?s position on the FAS 106 credit and it should be relied upon.

Second, the Attorney General?s Brief addresses Mr. Effron?s claim that a FAS 106 credit should be made for NUSCO. Consistent with his proposal to credit phantom savings, Mr. Effron adds a dollar amount of credit, which he attributes to NUSCO. Attorney General Brief, p. 9. No credit should be given for NUSCO employees because the fact is that no NUSCO employees were affected by the July 23, 1999 fossil/hydro sale. Cite. The phantom savings that Mr. Effron applies to NUSCO is simply another illustration of the infirmities of the Attorney General?s argument and why it should be rejected.

E. CONCLUSION

The Department specified that the manner in which the FAS 106 obligation was to be treated in its Order in D.T.E. 97-120 was through an actuarial analysis of all the factors, including a number relating to the significant uncertainties regarding the ultimate cost to customers. WMECO complied with this Order by obtaining an actuarial study from Towers Perrin weighing all these factors, and arriving at an proper adjustment to the FAS 106 balance. The actuarial report did not show a major adjustment to the FAS 106 balance because there were no large net reductions to WMECO?s FAS 106 costs in the new analysis, which takes into account the divestiture of the fossil/hydro sale.

The Attorney General?s proposal, on the other hand, rests on an immediate raid of the FAS 106 unrecognized gain, ignoring the fact this is inconsistent with the actuarial studies and ignoring the problems, including volatility, this will cause later. Based on the Department?s directives in D.T.E. 97-120 and the record in this proceeding, the Department must approve the actuarially-based method proposed by the Company and reject the Attorney General?s defective proposal.

VI. WMECO HAS COMPLIED WITH THE DEPARTMENT?S DIRECTIVE IN D.T.E. 97-120 WITH RESPECT TO THE EFFECT OF THE FOSSIL/HYDRO DIVESTITURE ON THE COMPANY?S FAS 87 PENSION OBLIGATION; THE ATTORNEY GENERAL?S PROPOSAL IS ACTUARIALLY UNSOUND AND OTHERWISE DEFECTIVE

A. IN D.T.E. 97-120, THE DEPARTMENT REQUIRED THAT AN ADJUSTMENT TO THE COMPANY?S PENSION OBLIGATIONS SHOULD BE REFLECTED AS OF THE TIME OF ASSET SALE.

In D.T.E. 97-120, the FAS 87 pension obligation was treated very differently from the FAS 106 post-retirement benefits obligation. While the FAS 106 obligation was allocated between distribution and generation, that was not the case with respect to the FAS 87 pension obligation. D.T.E. 97-120, p. 70. The FAS 87 pension obligation remained entirely in the distribution component of rates. D.T.E. 97-120, pp. 70-71. Apart from rejecting the Attorney General?s proposal that the pension value should be calculated by a ?corridor? method, the Department in D.T.E. 97-120 found only that ?consistent with its policy of unbundling the generation component, it is appropriate to recognize in the transition charge the effect of the divestiture on the Company?s pension obligation at the time of sale.? D.T.E. 97-120, pp. 71-72. This is exactly what the Company has done and no other proposal in this proceeding complies with the Department?s Order.

B. WMECO HAS COMPLIED WITH THE DEPARTMENT?S DIRECTIVE BY COMMISSIONING AN ACTUARIAL STUDY PERFORMED BY EXPERTS; THE CREDIT TO CUSTOMERS IS $1,753,839.

In response to the Department?s decision in D.T.E. 97-120, WMECO engaged actuarial experts, Hewitt Associates, LLC, to adjust WMECO?s Transition Costs for pension credits as a result of the divestiture of the fossil/hydro units. Exh. AG-IR-1-5, p. 4. The actuaries performed a straightforward analysis set forth on page 4 and 5 of Exh. AG-IR-1-5, with calculations shown on page 7 of that exhibit. As shown there, the actuaries took the projected benefit obligation (?PBO?) for the approximately 1338 WMECO active or retired employees eligible for pension benefits and updated it from January 1, 1999 to the date of divestiture (July 23, 1999). Exh. AG-IR-1-5, pp. 4, 7. When the PBO is adjusted for the effects of the divestiture, reflecting the fact that the pension obligation for the employees is better known, the result is a credit of $1,753,839 (shown below the last row of the table on page 7).

This study is the only actuarially developed calculation of the adjustment to the transition charge for pension expense in this proceeding,[5] and represents the best judgment of the expert actuaries in determining the adjustment to be made to the Transition Costs given the directives in the Department?s D.T.E. 97-120 Order.

C. THE ATTORNEY GENERAL?S FAS 87 PROPOSAL SUFFERS FROM EVEN MORE INFIRMITIES THAN HIS FAS 106 PROPOSAL.

1. The Adjustment To The FAS 87 Pension Obligation Must Be Performed According to Actuarial Principles.

As is the case with FAS 106, an adjustment to a FAS 87 pension obligation must be done according to actuarial principles. It is exceedingly easy for the Attorney General to ignore these principles and raid WMECO?s unrecognized pension gain ($70,736,000), resulting in a huge FAS 87 offset to the Transition Charge (see Exh. AG-1, Exh. DJE-1, p. 3). (Even then, however, the Attorney General?s witness cannot seem to come up with a consistent number (see Exh. DJE-1, p. 3, ($10,495,000) versus the amount shown on Exh. DJE-1R, p. 3 ($6,941,000)). But it is not appropriate to do so. The calculation of a pension obligation falls squarely in the province of actuaries and no credence should be afforded an analysis that, among other problems, is completely uninformed as to actuarial concepts and that has been assembled by someone completely unfamiliar with actuarial analysis. Exh. WM-5, pp. 8-9.

2. In Other Cases Mr. Effron Has Testified That A FAS 87 Pension Adjustment Must Be Made Based On Actuarial Analysis, Thus Undercutting His Proposal Here.

Attorney General witness Effron?s proposal to adjust the FAS 87 pension costs based on his own calculation in this proceeding is at odds with his testimony in prior proceedings. In those proceedings, he testified that FAS 87 costs should only be adjusted based on actuarial studies ? such as the one WMECO has commissioned. In Potomac Electric Power Company, Case No. 8315 (February 1991), Mr. Effron stated in response to a question asking how pension expenses should be determined that:

> I recommend that the latest actuarial study available be used for the purpose of determining the pension expense to be included in the cost of service. In my opinion, the actuarial study represents the best basis for estimating the normal periodic pension cost. Many factors affect the determination of the net pension cost, and without a complete actuarial study, it is difficult to estimate how the changes taking place from time to time will affect the period pension cost to be recognized by the Company [p. 28]. [Exh. DTE-RR-14(h).]

Mr. Effron expressed the same opinion more recently. In Application of Virginia Natural Gas, Case No. PUE960227 (February 18, 1997), he again stated in his pre-filed testimony that pension expense should be based on the ?latest available actuarial study? (p.

15). Exh. DTE-RR-14(p).

Accordingly, the Attorney General is advocating a position in this case (pension expense should be adjusted without an actuarial study) that his own witness has contradicted in prior testimony (pension expense should be adjusted based only on an actuarial study). Given Mr. Effron?s contrary testimony in prior cases, the Department should reject the Attorney General?s proposal here.

3. The Attorney General?s Allocation Of Pension Costs To Generation Has No Proper Basis.

As indicated above, the Department in D.T.E. 97-120 did not allocate any portion of the FAS 87 pension balance to generation. Thus, FAS 87 pension balances are considered only in distribution rates. D.T.E. 97-120, pp. 69-71. Now the Attorney General has proposed that unrecognized pension gain be allocated to generation based on a FAS 106 allocation. First, the Attorney General provided no evidence to demonstrate that any pension allocation to generation, if an allocation were to be warranted, should be the same as the FAS 106 allocation. Second, any allocation to generation flies in the face of the D.T.E. 97-120 proceeding which, as is stated above, there was no allocation of FAS 87 to generation.

The Department should not adjust distribution balances in a proceeding dealing exclusively with Transition Costs (that is, generation-related costs). Pension balances, which are included in distribution rates should be dealt with when those rates are under consideration. To do otherwise improperly ties generation to distribution. If, for example, FAS 87 distribution balances are improperly affected in this proceeding, the Company could be forced to file a general distribution rate case in response to that result. This would be an unduly confusing, inefficient way in which to proceed.

In sum, the Department should reject the Attorney General?s attempt to adjust FAS 87 pension balances in the Transition Charge when the FAS 87 balance is a distribution rate issue. The Department?s only adjustment to FAS 87 in this proceeding should be in accordance with the Department?s directive that the Transition Charge recognize ?the effect of the divestiture on the Company?s pension obligation at the time of sale?. D.T.E. 97-120, p. 71. That is exactly what WMECO has done.

4. The Attorney General?s Raid Of The FAS 87 Pension Balance Should Be Rejected.

The Attorney General advocates raiding the pension fund by stripping away the total unrecognized net gain to calculate the amount that should be credited to customers immediately. This is an improper and dangerous proposal. As stated in WMECO?s discussion of the FAS 106 Transition Obligation, such a tactic will only set the stage for volatility in what customers must pay for pension costs, without saving customers one dime in the long run (see Section V.C.2). The fact that there is an unrecognized gain as of July 23, 1999 is a positive development but it does not tell us where the fund stands today or where it will stand over time. Just as it is foolhardy to assume that a company?s stock value will remain at a historic high, it is foolhardy to assume that the pension fund will continue to earn the high returns experienced in the mid-to late 1990?s. Almost inevitably, there will be a downturn (in fact, a reduction in the unrecognized gain may have already occurred subsequent to the July 23, 1999 study date), which will reduce the value of the pension fund. Therefore, it is important that a sufficient balance be maintained in the fund now.

As with the Attorney General?s proposed raid on the FAS 106 balance, the Department should recognize the fallacy in the Attorney General?s suggestion that pension costs have dramatically diminished as a result of the fossil/hydro asset divestiture. That is simply not the case. Even for those employees in the sold group, WMECO retains the obligation to pay these employees? pensions. Exhibit. AG-IR-1-5 shows that overall pension costs have changed very little between January 1, 1999 and July 23, 1999.

5. The Attorney General?s Proposal Is Harmful To Customers Over Time.

The Attorney General makes it sound like his proposal is more beneficial to customers. That is not correct. Customers will receive credit for everything in the pension fund over time as a result of asset divestiture and in distribution rates. Tr. 2, pp. 187-188. The only difference is that the credit will be flowed back in an actuarially consistent manner as actual pension costs become known, and volatility will be eliminated or greatly diminished.

D. THE ATTORNEY GENERAL?S BRIEF ADDS NOTHING TO HIS ARGUMENT.

The substance of the Attorney General?s arguments has been responded to in subsection C, above. The Company offers the following additional comments based on specific language in the Attorney General?s Brief:

1. The Attorney General Has Failed to Explain Why An Actuarial Analysis Based on Costs Should Not Be Used.

The Attorney General admits that WMECO?s calculation of the credit to the transition charge is based on a study done by actuarial experts, Hewitt Associates. Attorney General Brief, p. 10. Having (a) made that admission, (b) offered a selective, misleading quote from

D.T.E. 97-120 (which leaves out the key words ?it is appropriate to recognize in the transition charge the effect of the divestiture on the Company?s pension obligation at the time of sale?), and (c) failed to provide any further analysis, the Attorney General somehow leaps to the conclusion that the Company?s method must be rejected. Attorney General Brief, p. 11. As shown by the Company above, nothing could be further from the truth. The Company?s method is the only one that has any basis in actuarial science and reality.

2. The Absurdity Of The Attorney General?s Adjustment For One Employee Demonstrates The Invalidity Of His Proposal.

In the course of its proposal, the Attorney General states that a pension balance adjustment should be made for one more employee. The Attorney General agrees that WMECO remains responsible for paying this employee?s vested pension benefits. However, the Attorney General then indicates that the pension fund should be adjusted downward for this one employee by over $800,000. Attorney General Brief, p. 12. This adjustment shows the absurdity of the Attorney General?s proposal. If, under his theory, the pension fund obligation should be adjusted downward by more than $800,000 for one employee for whom WMECO is still responsible, it is obvious that the Attorney General?s proposal will soon bankrupt the fund. WMECO has 1,338 active and retired employees eligible for pensions (Exh. WM-5, p. 10), and WMECO?s pension fund had only a fair market value of a little over $200 million on July 23, 1999 (Exh. AG-IR-1-5). Either the Attorney General?s proposal is flawed or there is not nearly enough money in the fund and WMECO should be collecting far more from customers than it does now.

3. The Attorney General?s Assertion That WMECO?s Actuarial

Study Did Not Take Into Account Unrecognized Gains And Losses And Other Factors Is Directly Contradicted By The Language In The Study.

The Attorney General further alleges that WMECO?s actuarial study bears no relevance to FAS 87 actuarial gains, did not take into account the ?unrecognized transition obligation, prior service cost, and the unrecognized gains and losses existing at the time of divestiture? and that no ?hypothetical? study like WMECO?s can be adopted. Attorney General Brief, pp. 12-13. This assertion is completely wrong, as shown on WMECO?s actuarial study, Exh. AG-IR-1-5. The first column of page 7 of that document shows that the expert actuaries took into account the ?unrecognized gain and loss?, the ?prior service cost? and the ?funded status? (unrecognized obligation), among other factors, in calculating a pension fund credit. This allegation of the Attorney General, completely contradicted in the record, is unfortunately consistent with a number of his other contentions on this issue. The Attorney General?s claim is totally mistaken and should be rejected.

4. The Attorney General?s Contention With Respect to NUSCO Completely Misses the Mark.

The Attorney General raises an issue in his brief which again demonstrates the weakness of his non-actuarial method (pages 14-15). He claims that although no NUSCO employees were affected by the sale of the fossil/hydro assets that WMECO should provide a pension credit relating to NUSCO, in an amount almost as large as the entire credit calculated by the expert actuaries. Attorney General Brief, p. 15.

Mr. Baumann explained why the Attorney General?s method is incorrect. He stated, without contradiction on the record, that ?no NUSCO employees were transferred? or otherwise affected by the fossil/hydro asset sale. Exh. WM-5, p. 14. He stated, therefore, that no allocation of the pension credit based on NUSCO was proper. Mr. Baumann put NUSCO in the same category as Northeast Nuclear Service Company (NNECO), another service company for which the Attorney General agreed no allocation was warranted. Exh. WM-5, p. 14.

It is true that the Department in D.T.E. 97-120 stated that **appropriate** allocations related to NUSCO and NNECO should be reflected as credits to the pension obligation. D.T.E. 97-120. p. 71. That does not mean, however, that for an asset divestiture in which no NUSCO or NNECO employees were involved that there are any appropriate allocations. Future divestitures may involve NUSCO or NNECO and there may be allocations that are appropriate as a result of those sales. That is not the case in this sale and no allocations are appropriate.

5. The Attorney General?s Proposal Is Contrary to D.T.E. 97-120.

Finally, with respect to FAS 87, the Attorney General makes the unbelievable assertion that the Company has not, and cannot, assert the Attorney General?s FAS 87 scheme devised by Mr. Effron is inconsistent with the Department?s order in D.T.E. 97-120. Attorney General Brief, p. 15. On the contrary, that is exactly what Mr. Baumann and Mr. Stack have testified to and what the evidentiary record in this proceeding shows. The Company has consistently and repeatedly taken issue with the completely flawed proposal proposed by the Attorney General.

E. CONCLUSION

In this proceeding, the Attorney General requests that a huge adjustment be made to the

WMECO?s FAS 87 distribution pension balance. But, the Attorney General has produced no actuarial study to justify this adjustment and it is improper to make an adjustment in the absence of a study. In addition, an adjustment to the unrecognized gain in WMECO?s FAS 87 balances is an adjustment to distribution rates and no such adjustment is appropriate to a Transition Charge reconciliation (generation cost) proceeding. In addition, the effect of the Attorney General?s raid on WMECO?s FAS 87 unrecognized gain is likely to cause customers problems because, for example, it could lead to volatility in the pension costs or gains that customers see or necessitate a general distribution rate case.

WMECO, on the other hand, has followed precisely the Department?s direction in D.T.E. 97-120. It has produced an actuarial study that shows how pension balances are affected by the fossil/hydro divestiture and has credited that amount to customers. Apart from the amount so credited in generation due to divestiture, customers are getting the full credit of pension balances through distribution rates. This is the only appropriate proposal in this proceeding and the Department should approve the Company?s proposal.

VII. INCLUSION OF THE INVESTMENT TAX CREDIT AS AN OFFSET TO TRANSITION COSTS IS A VIOLATION OF INTERNAL REVENUE SERVICE RULES, PLAIN AND SIMPLE; WISHING THE RULES WERE DIFFERENT DOES NOT MAKE IT SO.

A. WMECO HAS PRESENTED THE ONLY HONEST EVALUATION OF THE ITC RULES.

In his rebuttal testimony, Exh. WM-6, Mr. Stack cogently sets forth the development and status of investment tax credits (?ITC?). He testified that ITC were tax credits provided to WMECO and other companies in connection with certain of their investments in generation facilities. Congress discontinued the accrual of ITC in 1986. Exh. WM-6, pp. 2-3. The issue pertaining to ITC in this proceeding is whether the amortization of ITC relating to the fossil/hydro assets sold in 1999 is allowed as a reduction in rates under the Internal Revenue Code.[6]

Mr. Stack, who is the chief tax accounting officer for the NU system and was previously a partner at Arthur Andersen LLP, testified persuasively that a reduction to rates would result in negative consequences to WMECO and its customers. First, there is no question that the ITC relates to the fossil/hydro assets that were sold. Exh. WM-6, p. 3. Second, Mr. Stack states that Section 46(f) of the Internal Revenue Code contains the normalization requirements for ITC and that section 46(f) requires ITC to benefit regulated rates ?ratably? over the life of the asset. Exh. WM-6, pp. 3-4. The key word, according to Mr. Stack is ratably. It is defined as the ?period of time used in computing depreciation expense for purposes of reflecting operating results in the tax-payers regulated books of account. Once an asset is sold, the ratable period of time over which an asset is depreciated ceases.? Exh. WM-6, p. 4. Accordingly, based on Mr. Stack?s informed opinion, ?continuing to provide customers with the benefit of ITC amortization related to an asset that has been sold would be a normalization violation? under the Internal Revenue Code and the credit should not be returned to customers. Exh. WM-6, p. 3.

WMECO?s and NU?s position on ITC, as set forth by Mr. Stack, has been consistently expressed to the Department previously, from the time WMECO was ordered to divest its fossil/hydro generating assets as a result of the Electric Utility Restructuring Act (Chapter 164 of the Acts of 1997), to the time the Department was considering the divestiture of WMECO?s generating assets. In D.T.E. 97-120, WMECO?s restructuring proceeding, WMECO stated in response to an Attorney General data response: ?upon disposition of the fossil/hydro generating assets, WMECO will cease crediting customers (through the transition charge) for the fossil hydro portion of Accumulated Deferred ITC as continuing to credit would violate the ITC normalization rules?. Exh. AG-IR-2-32 (containing WMECO response to AG-IR-5-65 in D.T.E. 97-120). In addition, Mr. Stack has similarly testified in other states that to credit customers would be a normalization violation. New Hampshire, a state that has ruled on the issue, has agreed with Mr. Stack that it would be an ITC violation to continue to provide ITC credits to customers. Tr. 1, p. 78; Exh. DTE-RR-4; Exh. AG-IR-5-9.

Apart from the language of the Internal Revenue Code supporting Mr. Stack?s determination, his position that providing such a credit would be a normalization violation is supported fully by several of the IRS?s Private Letter Rulings (?PLRs?). A PLR is a ?written statement issued to the taxpayer by the national office [of the IRS] that interprets and applies the laws to the taxpayer?s specific set of facts.? Tr. 2, p. 227. The national office of the IRS assigns to an assistant chief counsel the task of responding to PLR requests. Tr. 2, pp. 227-228.

In Exh. AG-IR-2-32, Mr. Stack attached PLR 8745005, issued by the IRS in August 1987. That PLR, involving a very similar set of facts to that presented in this proceeding, concludes by stating that:

> In this case X [the party requesting the PLR] has sold the assets that generated the investment tax credit and, as a result, the asset for which regulated depreciation expense for which Y [the entity that regulates X] computes X?s cost of service is no longer available. Consequently, no portion of the related unamortized accumulated deferred investment tax credit remaining at the date of

the sale of Z [the assets being sold] may be used to reduce X?s cost of service.

Any question that the IRS may have changed its interpretation of the law since 1987 is put to rest by the most recent PLR on the subject from the IRS, PLR 105884-99, issued on October 26, 1999. In language that could not be any clearer, in a case whose facts are remarkably similar, if not identical, to those presented here, the IRS stated:

> Hence, in each of the three rulings requested by Taxpayer [Southern California Edison Company], there would be a normalization violation if the remaining unamortized ADITC [accumulated deferred investment tax credit] and ARAM [average rate assumption method] benefits balances (or a proportionate part thereof) existing at the date of sale are returned to ratepayers by amortizing those amounts in a TCBA [Transition Cost Balancing Account]. Since Taxpayer has sold the assets that generated the ADITC, the asset for which regulated depreciation expense is computed is no longer available. Consequently, no portion of the related unamortized ADITC remaining at the date of sale may be returned to ratepayers by amortizing those amounts to a TCBA [Exh. WM-6, Attachment, p. 7].

In his rebuttal testimony, Mr. Stack also laid to rest any possibility that the IRS allows a company to credit ITC to customers indirectly when it cannot do it directly. He testified that the IRS normalization rules ?look beyond the form of ratemaking; they look to the substance. A normalization violation occurs if a regulator directly or indirectly provides customers the ITC benefit related to plant that has been sold.? Exh. WM-6, p. 5. Specifically, Mr. Stack quoted Section 1.46-6(b)(4)(i), (ii) and (iii) of the IRS regulations providing that:

> cost of service is considered to have been reduced by reason of all or a portion of a investment tax credit if such reduction is made in an indirect manner. Under regulation section 1.46(b)(4)(ii), **one type of such indirect reduction is any ratemaking decision in which the credit is treated as operating income subject to ratemaking regulation?.** According to 1.46(b)(4)(ii), **a second type of indirect reduction is any ratemaking decision intended to achieve an effect similar to a direct reduction to cost of service or ratebase**. In determining whether a ratemaking decision is intended to achieve this effect consideration is given to all the relevant facts and circumstances of

each case?? Exh. WM-6, p. 7 (emphasis supplied).

Based upon the foregoing information and based on his general expertise in the tax and accounting areas, Mr. Stack has concluded that any attempt to flow back ITC credits to customers relating to the sold fossil/hydro assets would violate the tax laws.[2] Tr. 1, p. 72. Accordingly, in any tax return that he files that reflects an intent to flow back these ITC credits, he could have to ?self-assess,? in effect notifying the IRS of the violation and giving back the ITC. Tr. 1, pp. 71, 90. Mr. Stack will not file a tax return with an illegal ITC credit, regardless of the odds the IRS will catch the violation. He will not commit a crime just because there is a chance he will not get caught. Tr. 1, pp. 71-72.

Finally, it must be recognized, as Mr. Effron himself agreed in response to a question from the Bench, that with respect to ITC ?customers have not only fully recovered the cost of the divested plant, but even more so.? And, he agreed further that there is no cost for the investment tax credit to offset. Tr. 2, p. 266.

As shown in the foregoing, WMECO?s treatment of ITC is the only one that may be adopted. Customers have fully recovered the cost of the fossil/hydro units at issue here, and the IRS rules, supported by the guidance provided by PLRs, is absolutely clear that ITC from sold generation assets cannot be credited to customers.

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[2] While Mr. Stack is not in a position to know what violations are caught and penalties assessed between the IRS and individual taxpayers, there is no reason to believe that the IRS does not vigorously enforce its ITC normalization rules. See, for example, Exh. AG-RR-1.

B. THE ATTORNEY GENERAL?S THEORY WITH RESPECT TO THE RECOVERY OF ITC IS EMBARRASSINGLY WEAK AND MUST BE REJECTED.

The Attorney General?s argument with respect to the recovery of ITC seems to boil down to a few points. First, the Attorney General?s witness claims PLRs are meaningless and that he doesn?t agree with the IRS?s interpretation anyway. Second, he claims that because two electric companies may or may not have taken a different posture with respect to ITC, a posture which exposes them to penalties, that WMECO should take a position that violates the Internal Revenue Code. Third, the Attorney General?s witness suggests that WMECO violate the IRS code and try to cover it up by confusing the IRS. None of these arguments are worth serious consideration.

1. The Attorney General?s Claims With Respect To PLRs Are Bizarre.

The Attorney General?s witness Effron takes the untenable position on the IRS PLRs, which would be laughable if this were not such a serious matter, that PLRs are more or less random events that have no bearing on anyone except perhaps the taxpayer that requests them. *See, e.g.,* Exh. AG-1, p. 22. Mr. Effron admits to reading PLRs in the past, but he testified that he really does not know why he did so. Tr. 2, p. 224. He further testified that he did not know that the national office of the IRS issues PLRs. He also stated that he had not read PLR-105884-99, the most important PLR relating to ITC normalization violations, before submitting his testimony. Tr. 2, pp. 227-228. His ignorance, or feigned ignorance, about PLRs in general and about PLR-105884-99 in particular, is a monumentally damning admission for someone that claims to be familiar with tax and accounting practices for regulated entities.

In contrast to Mr. Effron?s position, Mr. Stack testified that although a PLR cannot be used by a non-requesting taxpayer as precedent, a PLR provides a ?very good indication of how the IRS would rule on any similar matter?.[7] Exh. WM-6, p. 5. He agreed with the Bench that ?private letter rulings are cited all the time in papers, position papers, filed with the [IRS].? Tr. 1, p. 94. Mr. Stack?s expert opinion is that PLRs have been ?closely scrutinized by utility companies and their regulators for guidance in general. Further, to ignore the IRS?s clearly defined position in a PLR would be inappropriate?. Exh. WM-6, p. 5. Mr. Stack does not take issue with the fact that the IRS through a PLR cannot supersede existing law,[3] but PLRs are a very important factor in confirming how existing law is to be implemented (as discussed above, Mr. Stack does not rely only on PLRs but also on existing law). Based on the record, there can be no doubt that Mr. Effron is totally wrong with his interpretation of PLRs and that Mr. Stack has it exactly right.

After reading PLR-105884-99, it is easy to see what Mr. Effron?s real problem is with the PLRs on this issue. The problem is the PLRs completely undermine the Attorney General?s position. On cross-examination Mr. Effron was forced to argue the untenable position that he should be relied upon rather than the IRS because the IRS was wrong in PLR-105884-99 in concluding that an ITC violation existed. Tr. 2, p. 230. Unfortunately for the Attorney General but, based on the level of Mr. Effron?s testimony, fortunately for the rest of the country, Mr. Effron does not have the authority to decide if an ITC violation exists: the IRS does that, whether the Attorney General likes it or not. The IRS makes the rules and companies are

[3] For that reason, the Pennsylvania case cited by the Attorney General on page 18 of his brief is irrelevant. No one is claiming the PLRs have the force of law. The Attorney General?s attempt to divert

obliged to follow them.

In its review of the ITC issue, no credibility can be placed on the Attorney General?s position with respect to PLRs. In fact, the Attorney General?s ignorance on this issue forcefully argues against his credibility on other issues.

2. Other Electric Companies Do Not Provide Guidance On The ITC Issue.

Second, the Attorney General claims that because Fitchburg Gas and Electric Light Company (?Fitchburg?) and Montaup Electric Company (?Montaup?) (a company now absorbed into National Grid) may have made regulatory filings (to the Department and the FERC, respectively) that included provision for a credit of ITC, that WMECO should follow this risky path. Exh. WM-2, p. 22. In response, the record shows that there is no way to know what Fitchburg and Montaup did without examining their tax returns and determining, for example, if they self-assessed for an ITC violation. Tr. 1, p. 95. In addition, there are any number of reasons that those companies may have proceeded in a particular manner (*e.g.*, side agreements with the parties in their particular proceedings) that are not in the record of this proceeding and that the parties to this proceeding will never know. In addition, as Mr. Stack testified, in questioning by the Bench, even if Fitchburg and Montaup treated the ITC credit in a certain way, no one can conclude that the IRS agrees with such an approach until the IRS audits the returns. Tr. 1, p. 95. And, because this ITC issue is still a relatively new one, it could be that the IRS is only now really examining companies? tax returns that raise the issue. Tr. 1, p. 88.

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attention by raising such a point shows how devoid of merit his main contention is.

A late claim to try to buttress the Attorney General?s weak arguments with respect to ITC, a claim that was not made in either Mr. Effron?s direct or surrebuttal testimony, and which was aired only on the last day of Mr. Effron?s testimony, was that New England Power Company and Boston Edison Company also provided a credit for ITC. Tr. 2, pp. 284-285. Mr. Effron did not testify to this of his own knowledge but was relying on others in the Attorney General?s office. Tr. 2, p. 285. The material provided in an attempt to support his assertions, however, does not support the position he is passing along. Exh. DTE-RR-15 shows no indication that ITC was returned by National Grid or any NStar company. Again, there is no way of knowing what occurred in the New England Power Company and Boston Edison Company cases, or what agreements were arrived at between the parties. If, in fact, there was some ITC credit, which is completely unsubstantiated, it was done surreptitiously, which only is even more support for WMECO?s position that to provide the credit would be a normalization violation.

3. Concealing A Violation From The IRS As the Attorney General Advocates Is Improper.

The need to hide the ITC credit from the IRS goes to the third point raised by the Attorney General. While not admitting that there is an ITC violation, Mr. Effron would have the Company engage in certain practices to hide from the IRS what is really taking place. Exh. AG-2, pp. 22. As Mr. Stack testified, the Internal Revenue Code prohibits doing indirectly what cannot be done legally directly. Exh. AG-6, pp. 6-7.

C. CONCLUSION

The discussion above demonstrates that the Attorney General?s position with respect to the ITC has no merit. Customers have paid solely for the cost of the divested plant related to the period the plant was used to generate electricity. Customers have properly received tax benefits of depreciation and ITC for that portion of the plant. Any gains as a result of the sale have properly reduced Transition Costs. Based on the law and the PLRs interpreting the law, WMECO?s filing properly recognized that any attempt to offset ITC credits against the transition costs would violate the Internal Revenue Code and expose WMECO to penalties.

VIII. FURTHER REDUCTIONS TO TRANSITION COSTS CLAIMED BY THE ATTORNEY GENERAL ARE IMPROPERLY RAISED IN THIS PROCEEDING AND/OR ARE TOTALLY WITHOUT MERIT.

A. THERE CAN BE NO ADJUSTMENT OF TRANSITION COSTS FOR THE MADISON/OTHER WHOLESALE CONTRACTS THAT WERE TOTALLY INSULATED FROM WMECO?S CUSTOMERS.

1. Introduction.

The ?Madison? contract refers to a contract signed by The Connecticut Light and Power Company (?CL&P?) and WMECO to serve the Town of Madison Department of

Electric Works. Madison is a municipality in Maine. Tr. 2, pp. 140, 148; Exh. DTE-RR-5. Madison was the first full requirements contract. Later, NU signed similar, smaller full requirements contracts. Tr. 1, pp. 141-142. Because Madison was the first and largest contract of this kind, the contracts became known as Madison-type sales. Tr. 1, p. 142. (For ease of reference the Madison and other full-requirements contracts will henceforth be collectively referred to as the ?Madison? contract.) The Madison contract was completely insulated from WMECO?s customers; customers bore no cost and no risk associated with the contract and, appropriately, none of the costs or revenues from the Madison contract has been applied toward WMECO?s transition charge. Exh. WM-5, pp. 20-21.

2. The Finality Of Department Decisions Bars The Attorney General From Raising The Madison/Other Issue In This Proceeding.

As indicated above in Section II (Procedural History) and III (Standard of Review), the Department, in D.T.E. 97-120, fully identified and determined ?those costs and categories of costs for generation-related assets, investments, and obligations?which may be allowed to be recovered through a non-bypassable transition charge?? G.L. c. 164, ? 1G(a)(1). As indicated above, the Department heard from numerous witnesses in D.T.E. 97-120, including Mr. Effron and others retained by the Attorney General?s office. The Department also reviewed tens of thousands of pages of material on every conceivable topic in reaching its decision to approve WMECO?s restructuring plan. Although the Madison contract was in place at the time of the D.T.E. 97-120 proceeding and its treatment was disclosed to the Attorney General in various fuel adjustment filings (*see, e.g.*, Exh. DTE-RR-5 (WMECO?s Fuel Adjustment filing in D.P.U. 96-8C (August 8, 1996), Schedule 5), and fuel charge costs were at issue in D.T.E. 97-120 (*see* D.T.E. 97-120 (September 17, 1999), pp. 60-61), the Attorney General never raised any issue concerning the Madison contract in WMECO?s restructuring proceeding. Tr. 2, p. 237.

There could be many explanations for why the Attorney General did not raise the precise Madison contract in the restructuring case.[8] Whatever the explanation, however, the result is the same: the Department has ruled on the categories of costs which can be recovered and the Attorney General is barred by *res judicata* from raising the Madison contract issue in this or any future reconciliation proceeding.[4]

Res judicata incorporates the judicial doctrines of issue preclusion and claim preclusion.[5] ? In Massachusetts, claim preclusion renders ? a valid, final judgment conclusive on the parties and their privies, and bars further litigation of all matters that were or *should have been adjudicated* in the action?[6] Claim preclusion may apply, upon a party?s showing of three elements: ? (1) the identity or privity of the parties to the present and prior actions; (2) identity of the cause of action; and (3) prior final judgment on the merits.?[7]

Claim preclusion is grounded on fundamental notions of fairness and judicial/administrative efficiency.[8] It would be unfair to a party who believed an issue to be settled to have to be perennially at risk that an opposing party will raise the issue. Thus, to

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[4] That the Madison contract could have and should have been raised in D.T.E. 97-120 distinguishes it from other issues, such as those pertaining to the divestiture of fossil/hydro assets, which could not have been adjudicated in D.T.E. 97-120 and are appropriately at issue in this proceeding.

[5] *Blanchette v. Sch. Comm.*, 427 Mass. 176, 180, n.3 (1998).

[6] *Levenson v. Feuer*, No. CA 1997-04699-F, 402 Mass. Super. LEXIS 303, at *28 (Mass. Super. Ct. May 24, 2000), *quoting Heacock v. Heacock*, 402 Mass. 21, 23 (1998) (emphasis added).

[7] *Id*., *quoting Gloucester Marine Rys. Corp. v. Charles Parisi, Inc.*, 36 Mass. App. 386, 390 (1994). There are exceptions to the principles of res judicata and claim preclusion but they do not apply here. Exceptions exist when the court of agency did not have subject matter jurisdiction, the power to award full relief, or there was a clear usurpation of power. Conservation Comm?n v. Pacheco, 49 Mass. App. Ct. 737, 742 (2000).

allow a ? second bite at the apple ? contravenes all elements of efficiency and fairness.[9] Moreover, public policy favors a doctrine that there is a finality to litigation.[10]

The first element of claim preclusion is met in this situation because the parties in the present action, the Attorney General and WMECO, are the same parties that were involved in the restructuring plan proceeding, D.T.E. 97-120. Likewise, the second element of claim preclusion is met in this instance because the same issue of recovery of transition costs is being adjudicated.

The third element of claim preclusion is also met because the Department issued a final order. In *Stowe v. Bologna*, the Supreme Judicial Court stated that ? [a] final order of an administrative agency in an adjudicatory proceeding, not appealed from and to which the appeal period has expired, precludes relitigation of the same issues between the same parties, just as would a final judgment of a court of competent jurisdiction?.[11] The court stated that subsequent hearings between the board and the parties were not meant to reopen the original hearings and, thus, unless a party moved to have the proceedings reopened, the decision made in the original hearing were final.[12] The SJC has specifically held the that the decisions of the Department are final at the conclusion of each stage of a proceeding, unless appealed.[13]

In this instance WMECO?s restructuring plan has been decided and the period for

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[8] *Levinson*, 2000 Mass. Super. LEXIS 303 at *34, *citing Gloucester*, 36 Mass. App. at 390.

[9] See *Blanchette*, 427 Mass. at 181.

[10] *Pacheo*, 49 Mass. App. Ct. at 742, *quoting Wright Mach. Corp. v. Seaman-Andwall Corp*., 364 Mass. 683, 688 (1974).

[11] 415 Mass. 20, 22 (1993), *quoting United States v. Utah Constr. & Mining Co*., 384 U.S. 394, 421-22 (1966).

[12] *Id.*

[13] *See Sudbury v. Dep?t of Pub. Utils.*, 343 Mass. 428, 433 (1962).

requesting reconsideration, clarification or appealing to the courts has long since expired. As such the case and the points at issue in D.T.E. 97-120 are closed. The doctrine of *res judicata* as it applies to claim protection fully applies.

The havoc that would be created should the Department proceed to the merits of the Madison contract issue in this proceeding is easy to see. Reconciliation proceedings, instead of being cases in which ?the difference between projected transition costs and actual transition costs? are reconciled (G.L. c. 164, ? 1A), will be a continuation of the restructuring case.[14] If the Attorney General is allowed to raise the Madison issue here, he may, in next year?s reconciliation proceeding, decide to present other issues that could have and should have been litigated in the restructuring case-in-chief, claiming that he did not think of the issue during that proceeding. In addition, in future reconciliation proceedings, he may relitigate an issue decided in D.T.E. 97-120 claiming that he has thought of a new, better argument for disallowing certain WMECO costs.

The Department should not allow the Attorney General to make the reconciliation proceedings simply a continuation of the restructuring proceeding, with no issue barred, as the Attorney General proposes in the Standard of Review section of his brief. The far better result is for the Department to recognize the finality of its own decisions and the doctrine of *res judicata* and claim protection to limit reconciliations to the scope expressly set forth for them in G.L. c. 164, ? 1A. The Department should reject the Attorney General?s attempt to raise the Madison contract issue in this proceeding.

[14] *See* Section III, above, for the proper Standard of Review in this proceeding.

3. On The Merits, The Attorney General?s Claim With Regard To The Madison Contract Is Exceedingly Weak And Must Be Rejected.

The Attorney General?s position on brief with respect to the Madison contract is illogical, and should be rejected. The facts behind the Madison contract are fairly simple. CL&P (WMECO?s much larger Connecticut affiliate) and WMECO agreed to serve Madison under a new regulatory system that was just starting to emerge in the mid-1990?s. Tr. 1, p. 65. Markets were opening up to competition and large customers were bidding for service. Tr. 1, pp. 64-65. The sources of supply for the Madison contract were from various parties and a portion may have come from generation facilities on the NU system. Tr. 1, p. 63. The precedent from day one of the Madison contract was to remove incremental costs for supplying the requirements of the Madison contract from costs that WMECO?s retail customers supported.[9] Tr. 1, pp. 65, 111; Tr. 2, p. 144; Exh. WM-5, p. 21. Customers were completely neutralized as to the effects of this market contract because inherent in the contract were market risks that were never placed on customers. Tr. 1, p. 66. The treatment of insulating customers from the risks and benefits of the Madison contract was repeatedly reflected in WMECO?s fuel adjustment charge (?FAC?) filings (*see* Exh. DTE-RR-5) and approved by the Department in its quarterly FAC orders.

Furthermore, Mr. Baumann testified on a number of occasions that there were no additional costs associated with the Madison contract because no additional capacity costs were imposed on the Company (Tr. 2, pp. 146, 150, 152) and the Attorney General?s witness has not challenged that position. Mr. Baumann also stated that any costs allocated to WMECO as a result of the Madison contract through the Northeast Utilities Generating and Transmission Agreement (?NUG&T?) were removed from the FAC calculations. Exh. DTE-RR-7.

In response to the Company?s position, the Attorney General can only claim that: (1) although WMECO has removed the energy costs associated with Madison from generating operating costs it has not recognized capacity and energy revenue in excess of cost; and (2) the Company?s customers are bearing fixed costs associated with the contract so customers should be assigned all the benefits of the contract.[15]

These two points have been refuted in Mr. Baumann?s testimony set forth above. WMECO removed all of the costs and revenues relating to Madison to keep its customers insulated from the contract. It certainly is not appropriate to recognize revenues if costs have been eliminated. As to the second point, Mr. Baumann testified that as an incremental contract there were no costs borne by customers other than the energy costs, which were eliminated from the fuel adjustment charge. In any case, it does not follow that if there were some fixed costs that all the benefits of the contract should somehow be granted to WMECO customers as a windfall.

4. Conclusion

[15] In the Attorney General?s Brief and in Exh. AG-2, there is reference to Exh. AG-3, the Formula for Calculating Transition Charges, Section 1.1.3(b)(ii). This is a red herring. As the Attorney General should know, this has to do with recovery of costs prior to asset divestiture and has nothing to do with the Madison contract.

The Department should reject the Attorney General?s arguments with respect to the Madison contract. The Company has followed a consistent policy of keeping customers insulated from the Madison contract and this has been approved by the Department through the fuel adjustment charge. The Attorney General?s tardy attempt to confuse the facts and the Department?s precedent on this issue should be dismissed.

B. THERE SHOULD BE NO ADJUSTMENT OF TRANSITION COSTS FOR THE TARIFF 7 OFF-SYSTEM SALES BECAUSE THESE SALES WERE TOTALLY INSULATED FROM WMECO?S CUSTOMERS.

1. Introduction

The T-7 Off-System Sales refer to contracts that are similar to Madison in the sense that they are incremental market-based contracts from which WMECO?s customers were totally insulated. Tr. 1, p. 111; Exh. AG-IR-1-13. Unlike Madison, however, these contracts weren?t supplied from NU sources at all. Tr. 1, p. 112. As an example, there were sales in Pennsylvania that were supplied from Canadian power. Tr. 1, p. 112.[10]

2. The Finality Of Department Decisions Bars The Attorney General From Raising The Tariff 7 Off-System Sales Issue In This Proceeding

As was explained with respect to the Madison contract issue, above, the recoverability of Tariff 7 Off-System Sales was within the scope of D.T.E. 97-120 and was decided in that proceeding. The Attorney General is precluded from raising the Tariff 7 Off-System Sales issue in this proceeding. Please refer to Subsection A.2, above, for a discussion of this point.

3. On The Merits, The Attorney General?s Claim With Regard To The Tariff 7 Contracts Is Exceedingly Weak And Must Be Rejected.

The Attorney General has made a half-hearted attempt to come up with some rationale to include an amount from Tariff 7 Off-System Sales as a credit to transition costs. None of these are credible and some statements are simply wrong. For example, the Attorney General states that since ?generation costs are included in the transition charge, the operating margin attributable to these sources should be credited against the generating operating costs? Attorney General Brief, p. 30. However, the generation related to Tariff 7 Off-System Sales has nothing to do with the Transition Charge.[11] All the Tariff 7 Off-System Sales involved non-NU, non-WMECO generation.

The Attorney General?s assertion is not consistent with his own witnesses testimony. Mr. Effron agreed at least twice in this proceeding that Tariff 7 Off-System Sales were connected to power purchased by NU and not NU?s own generation. WM-IR-1-16; Tr. 2, p. 239.

In addition, the Attorney General inexplicably claims that the Tariff 7 Off-System Sales are related to WMECO generation and that there is no evidence to the contrary. Attorney General Brief, p. 31. This is simply wrong. Mr. Baumann definitively testified that the Tariff 7 Off-System Sales had nothing to do with WMECO or NU generation. Tr. 1, p. 112.

As with the Attorney General?s contentions with respect to the Madison contract, his assertions with respect to Tariff 7 Off-System Sales also must be rejected. WMECO?s customers have been completely insulated from the Tariff 7 Off-System Sales and the transactions did not even involve generation on the NU system or a buyer on the NU system.

A. WMECO HAS PROPERLY DEDUCTED FROM THE NET PROCEEDS

OF ITS 1999 TRANSACTION INVOLVING FOSSIL/HYDRO ASSETS THE AMOUNT PERTAINING TO TRANSMISSION SERVICE.

1. The Value Of The Transmission Services Sold Has Been Demonstrated To Be $2.5 Million As Reflected In WMECO?s Filing.

As part of the generating facilities that WMECO sold in 1999 were Units 1 and 2 and a jet turbine generator at its West Springfield station. Tr. 3, p. 303.[12] Mr. Baumann testified that the purchaser of these generating units, CEEMI, needed transmission service over WMECO?s transmission lines in order to deliver the output of its newly-purchased units to the pool transmission facilities (PTF) network and the transmission grid. Tr. 3, p. 303. WMECO and CEEMI engaged in negotiations and agreed that the purchase price for the needed transmission access would be $2.5 million. *Id.*; Exh. WM-5, pp. 5-6. This amount is consistent with the Company?s approved Open Access Transmission Service Tariff No. 9 for prepaid charges related to point-to-point transmission service. Exh. AG-IR-5-11. The $2.5 million amount was received from CEEMI at the time of the sale of the generation assets. Tr. 3, p. 303.

The total amount received by WMECO for its fossil/hydro generation facilities and its transmission rights was $47 million, $44.5 million for the generating facilities and $2.5 million for transmission service. Tr. 3, p. 312. Mr. Baumann testified that it is not unusual for a purchaser to make a payment for transmission rights to access the PTF system at the time of purchase that is considered separate and distinct from the payment for generation. Tr. 3, p. 304.[16]

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[16] The Attorney General?s reference to ?reasoned consistency? with respect to transition service payments is misplaced (Attorney General Brief, p. 24, fn 11). There is no evidence that the Department has any precedent concerning transmission service payments taking place at the same time as a sale of a generation asset. Indeed, the testimony from Mr. Baumann is that such transmission service payments have

When WMECO calculated the net proceeds from the sale of the fossil/hydro generation, it properly deducted the $2.5 million relating to transmission. *Id.* It is proper because the Electric Utility Restructuring Act makes abundantly clear that only generation-related proceeds are to be used to apply against transition costs. Indeed transition costs refer only to those generation costs that are ?stranded.? For, example, G.L. c. 164, ? 1A(b)(3), states that ?[a]ll proceeds from any such divestiture and sale of **generation facilities?** shall be applied to reduce the amount of the selling electric company?s transition costs? (emphasis supplied). As a further example, G.L. c. 164, ? 1G(b)(1) states that transition costs may be recovered only for ?**generation-related assets and obligations** [determined] to have been prudently incurred and associated with producing electricity? (emphasis supplied). Transmission assets have never been included in the calculation of transition costs and are totally distinct and separate from the sale of generation assets.

The value for transmission service paid by CEEMI to WMECO shown on Exh. WM-1, Exh. RAB-4, p. 4B of 13, is appropriately deducted from the net proceeds of the fossil/hydro sale and credited to transmission, and no other treatment of these revenues is appropriate.

2. The Attorney General Is Confused And His Attempt To Reduce Transition Costs By Crediting Transmission Revenues Is Completely Unfounded.

In his brief, the Attorney General cannot seem to understand the difference between the $2.5 million received by the Company and the proceeds from the sale of the generating facilities. Attorney General Brief, p. 23. As indicated above, the distinction is simple, the $2.5 million is

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been negotiated at the time of asset divestiture in the past.

directly related to transmission service and the $44.5 million are the proceeds from the sale of generation. Compounding the confusion the Attorney General blindly claims that: (a) the Formula for Calculating Transition Charges (Exh. AG-3) does not include a category for intangible assets such as transmission costs (Attorney General Brief, p. 23); (b) the $2.5 million allocation to transmission was simply an income tax entry (Attorney General Brief, p. 23); and (c) there is no ?cost? associated with T-9 transmission access (Attorney General Brief, p. 25). Each point is incorrect and is addressed below.

(a) The Formula for Calculating Transition Charges. It should have been apparent to the Attorney General that the reason the Formula (Exh. AG-3) does not address transmission interconnection payments, as discussed above, is because the Formula only applies to generation-related costs. *See, e.g.*, p. 3. Because transition costs can only include generation-related costs there is no point for the Formula to address the inclusion or exclusion of transmission costs (or, for that matter, distribution costs).

(b) The Payment from CEEMI. The Attorney General?s allegation that there was no real payment for transmission access by CEEMI and the whole structure was simply done for income tax purposes was demolished by the testimony of WMECO?s witnesses at hearings. Mr. Baumann testified that a $2.5 million payment from CEEMI to WMECO was made for transmission rights. Tr. 3, p. 301. Further, while the Attorney General correctly points out that the Second Amendment to the Purchase and Sale Agreement between WMECO and CEEMI (Exh. AG-3-10, Bulk Attachment) identifies the $2.5 allocation for transmission, this does nothing to support his contention. As Mr. Stack testified, ?any time an entity sells assets to another entity, they?re required in their tax returns? to complete Form 8594 which allocates the sales price to the various assets acquired. Tr. 3, pp. 311-312. Obviously, because part of the sale was for generation and part was for transmission, the parties to the transaction wanted to reflect properly the allocation to each in the Second Amendment to the Purchase and Sale Agreement. The fact that the $2.5 million allocation to transmission is set forth in the Purchase and Sale Agreement supports the Company?s position and provides absolutely no support for the Attorney General?s claim.

(c) The Cost of Transmission. Along with his other claims, the Attorney General?s assertion that there is no ?cost? associated with T-9 transmission access is baffling. Attorney General Brief, p. 25. Even the Attorney General?s own witness admitted that there is a cost associated with transmitting power. Tr. 3, p. 221.

While the Attorney General might wish that it was not so, $2.5 million was the amount determined by the parties for the costs of T-9 transmission service. The Company submitted a revenue calculation of $2.5 million based on the allocation of these costs. Exh. AG-IR-5-11. Tr. 3, p. 349.

3. Customers Will Receive The Benefit Of The Transmission Payment Received From CEEMI.

WMECO?s customers will benefit from the transmission payment from CEEMI in the manner in which all transmission revenues benefit customers, through the operation of the FERC-approved tariff. Tr. 3, p. 305. In fact, Mr. Baumann testified that the Company ?intends to file with the FERC? before the end of the year to recognize the revenues from

CEEMI. Tr. 3, p. 306.

The Attorney General's position with respect to customer benefit is not cogent. He repeats the discredited theory that customers are entitled to transmission revenues under the Restructuring Act (Attorney General Brief, p. 24) and states that recovery through customary FERC tariff channels will cost customers the time value of money. *Id.* The fact remains that transmission revenue is not intended to be reflected in the Transition Charge. If the Attorney General has a problem with the manner in which transmission costs are handled by FERC, he should take his complaint to FERC. In the meantime, WMECO will be following the rules set forth by FERC and recognizing the CEEMI payment in transmission rates.

D. THERE IS NO BASIS FOR INCLUDING SHORT-TERM DEBT IN WMECO'S CAPITAL STRUCTURE FOR 1999 AS ARGUED BY THE ATTORNEY GENERAL.

WMECO presented its capital structure for 1998 and 1999 in Exh. AG-1-35.[13] The Attorney General's witness does not take issue with the capital structure WMECO used for 1998. Exh. AG-1, p. 30. As set forth in Exh. AG-1-35, WMECO's long-term debt in 1998 was 55.41 percent, with preferred stock 6.22 percent and common equity 38.37 percent. Exh. AG-1-35, p. 1. In 1999, these ratios remained approximately the same; long-term debt was 51.49 percent, preferred was 8.73 percent and common equity was 42.05 percent. Inexplicably, however, the Attorney General has asserted that the 1999 capital structure must be artificially revised to reduce WMECO's cost of capital. Attorney General Brief, p. 21. The Attorney General would accomplish this by using a mechanism that has no identified precedent at the Department for electric companies -- including short-term debt in the calculation.[17] *See* D.T.E. 97-120, pp. 98-99.

Mr. Baumann eloquently explained at hearings why short-term debt has not been used by the Department or by other public utility commissions. He stated in response to a question from the Bench that:

> short-term debt has always been viewed as debt used in your current operations. It changes quickly. It goes up; it goes down. Whereas your long-term debt, your preferred stock, and certainly your equity, those ratios and those balances are more considered long-term in nature and really go towards the capital base of your company?. So that?s why we would hold consistent with what the Department has found over the years?to not include the short-term component as part of the capital structure [Tr. 2, pp. 136-137].

Mr. Baumann also testified that WMECO?s debt to equity ratios for 1999 were reasonable. Tr. 2, p. 135. He stated that:

> normally in a capital structure you try to create a balance between your equity component and your debt component?. I have been in enough proceedings to know that a 60 percent debt/40 percent equity ratio is a balanced ratio that companies have strived to maintain in their regulatory filings [Tr. 2, pp. 135-136].

The Attorney General?s response to the Company?s use of a reasonable capital ratio, that is employed pursuant to long-held Department precedent, is completely speculative and wrong. The Attorney General claims, without any foundation or basis, that WMECO?s capital structure in 1999 was ?less than the amount needed to finance the Company? (Attorney General Brief, p. 21). He then takes it upon himself to make believe that some, but not all,

[17] In response to a specific WMECO data response asking for any instances in which the Department used short-term debt in an electric company?s capital structure, the Attorney General could not identify one instance. Exh. WM-IR-1-41. In addition, short-term debt as the term is used here was not employed by the Company in D.T.E. 00-40. In that unique proceeding, an attempt was made to project a future capital structure (unlike the historical data being presented here) and ?short-term? was the label

short-term debt is long-term debt (though at short-term debt rates instead of long-term debt rates). His inadequate excuse is that he knows the relationship (without presenting any evidence to support his contention) between short-term and long-term debt. Further, the Attorney General?s position is contrary to that taken by his witness in a prior proceeding. In Exh. DTE-RR-14(i) (Toledo Edison 95-299-EL-AIR), Mr. Effron did not take issue with a capital structure of 45 percent equity for a number of electric utility companies (45 percent is similar to the equity ratio in place for WMECO in 1999, and did not propose to include short-term debt in the capital structure calculations (pp. 12-13; Exh. DJE-7, pp. 1-7).

The Attorney General?s position must be firmly dismissed by the Department. Apart from being based on unsupported allegations, it is contrary to the record in this case, which establishes that WMECO?s 1999 capital structure is reasonable. In addition, it is contrary to the essential difference between short-term and long-term debt to which Mr. Baumann testified and contrary to the Attorney General?s witness? prior testimony. Finally, it is contrary to the long-held precedent of the Department for calculating WMECO?s and all other electric companies cost of capital. The capital structure presented in Exh. AG-IR-1-35, as updated in Exh. AG-IR-3-8 (*see* Tr. 2, p. 133), should be used to determine the cost of capital in this proceeding.

E. THE DEPARTMENT HAS EXPRESSLY ALLOWED WMECO TO COLLECT GENERATION OPERATING COSTS, INCLUDING CAPITAL ADDITIONS, UP TO THE TIME OF DIVESTITURE FOR FOSSIL/HYDRO ASSETS AND THE START OF THE NUCLEAR PERFORMANCE-BASED RATEMAKING PROGRAM FOR NUCLEAR UNITS.

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given to the projected general debt supporting stranded generation assets. Exh. DTE-RR-11.

In D.T.E. 97-120, the Company proposed to collect ?total generation operating costs? through the generating operating costs component of the variable portion of the transition charge. D.T.E. 97-120 (September 17, 1999), p. 91. These total generation operating costs, including by definition the capital additions needed to continue to operate, were to be collected until divestiture for the fossil/hydro units and until the NUG&T was terminated and the nuclear performance-base ratemaking program started for Millstone 2 and 3. D.T.E. 97-120, pp. 87-88, 126-127; Exh. WM-5, p. 19.

In D.T.E. 97-120, the Attorney General challenged the Company?s proposal as a double-recovery, an assertion that the Department rejected (p. 91). The Department simply indicated that to the extent these costs were collected through the generating operating costs component of the variable portion of the transition charge (Column N, p. 3 of 14 of Exh.13E in D.T.E. 97-120; Exh. AG-3, p. 3 of 14 in this proceeding) they should not be collected elsewhere. *Id.*

Accordingly, the Formula for Calculating Transition Charges submitted and approved in WMECO?s compliance filing in D.T.E. 97-120 (Exh. DTE-RR-16 in this proceeding) contained Section 1.2.3(k), which provides for recovery as generation operating costs as follows:

> Generating Operating Costs - As described in Section III of the Company?s Revised Plan filed on September 4, 1998, until WMECO can resolve issues related to the NUG&T and divestiture of it[s] non-nuclear generating facilities, WMECO proposes that supply for Standard Service and Default Service will be provided by the NU system resources, as provided for under the NUG&T. During this interim period WMECO?s transition charge will be cost based to include the benefits of the NUG&T and the operating costs associated with Standard Service. The net costs associated with the aforementioned are included in Column (N) on page 3.

For the fossil/hydro facilities, a portion were sold during calendar year 1999 (as approved in D.T.E. 99-29) and the other fossil/hydro and nuclear facilities continued to supply Standard Service and Default Service until January 1, 2000. At that time, the NUG&T was terminated, the Department-mandated nuclear PBR began and a third-party began to supply WMECO?s Standard Service and Default Service load. Accordingly, the Department approved WMECO?s collection of capital additions and other ?total generating operating costs? for WMECO?s generating units until their sale or if not sold, until January 1, 2000.

The Attorney General makes the specious claim that because another section of the Formula for Calculating Transition Charges (Section 1.2.3(i), one that governs recovery in calendar 2000, WMECO should not be able to recover its legitimately-incurred 1998-1999 capital additions incurred to keep its plants running to supply its customers with Standard Service and Default Service.[14] [18] Attorney General Brief, p. 26.

Upon questioning by the Bench at hearings, the flimsy nature of the Attorney General?s assertion became apparent. Asked how ?recovering post-1995 cap adds through the generating/operating costs [is] inconsistent with the Department?s order on lost revenues? the Attorney General?s witness answered that ?I don?t think it is inconsistent with that piece of the order? (Tr. 2, pp.273-274). Asked again ?what [the Company] attempted to do here, in [Exh. WM-1] Exhibit RAB-4? [is] inconsistent with the Department order? the witness answered ?There is no part of the Department?s order that I could point to that would be inconsistent with what the company is proposing? (Tr. 2, pp. 274-275). Thus, the Attorney General?s

[18] WMECO does not take issue with Section 1.2.3(i). The nuclear PBR set forth in that section became effective upon the termination of the NUG&T (January 1, 2000).

witness has admitted that WMECO?s treatment is consistent and appropriate.

Finally, it is important to note that apart from raising its weak argument pertaining to the Formula for Recovering Transition Costs, the Attorney General has never claimed that the recovery of capital additions in the operating costs is in any way inconsistent with the overall plan set forth by the Department in D.T.E. 97-120. The Attorney General undoubtedly has remained silent on this point because the recovery of such costs is **exactly** what the Department anticipated in D.T.E. 97-120. WMECO?s units were operated to serve its customers and it is completely appropriate that the costs of this operation should be included in the calculation of transition costs for March 1, 1998 through 1999.

Section 1.2.3(k) of Exh. DTE-RR-16 is the language governing the March 1, 1998 through March 31, 1999 reconciliation period. For that reason and the other reasons set forth above, the Attorney General?s contention with respect to capital additions must be rejected.

F. WMECO HAS PROPERLY ADJUSTED THE FAS 106 ACCOUNT TO ELIMINATE ANY DOUBLE COUNTING; MR. EFFRON?S INSISTENCE ON FURTHER DISALLOWANCES IS MISPLACED.

In Section IV, above, WMECO has indicated that it will effect a reduction to the Company?s FAS 106 calculation to correct a double counting of the recovery of the FAS 106 asset. There is a double counting because a return of the FAS 106 obligation is shown both on Exh. WM-1, Exh. RAB-4, pages 3A and 6. The reduction of the double counting amounts to $1,248,000.[15] Tr. 1, p. 13.

The Attorney General witness asserts now, however, that in addition to a double counting of the recovery of the FAS 106 balance there is also a double recovery of the return that should be eliminated as well. Attorney General Brief, pp. 27-28. The Attorney General?s allegation is simply incorrect, as amply documented on the record.

For there to be a double counting of the return on the FAS 106 balance the return would have to be incorporated in both pages 3A and 6. This is not the case. As identified in Exh. AG-IR-1-10, the administrative and general expenses contained in the generation operating cost calculations on page 3A are the generation portion of the Company?s total administrative and general expenses, as developed for WMECO?s financial statements. There is no indication that these amounts developed for financial statements, including an amount for the recovery of the FAS 106 balance, earn any return. Indeed, Mr. Baumann put the matter to rest when he testified twice that there was no double counting. At the very beginning of hearings, Mr. Baumann testified that ?Mr. Effron also stated that there was a double-counting of the [FAS 106] return component, which is not the case? (Tr. 1, p. 13) Later, in response to a question from the Bench, he reiterated that ?the [FAS 106] return piece is not in the [administrative and general] piece on page 3-A? (Tr. 2, p. 167).

The Attorney General Brief states that ?Mr. Baumann did not challenge or object to Mr. Effron?s testimony on this issues [sic].? Attorney General Brief, p. 28. Perhaps the Attorney General forgot important testimony from hearings and did not read the transcript, but, as shown above, Mr. Baumann did take issue with Mr. Effron?s unsubstantiated assertion and set the record straight. The Attorney General?s position with respect to the imagined double recovery of the return on the FAS 106 balance must be rejected.

G. WMECO?S PROPOSAL TO CREDIT THE NET PROCEEDS OF THE SALE TO CUSTOMERS NOW RATHER THAN OVER A PERIOD OF YEARS THROUGH THE RESIDUAL VALUE CREDIT MORE IMMEDIATELY REFLECTS THE BENEFITS OF THE SALE TO CUSTOMERS

In its restructuring plan proceeding, the Company proposed the use of a Residual Value Credit (?RVC?). Exh. AG-3. An RVC takes the net proceeds from an asset sale and returns these net proceeds as a credit to the Transition Charge over a period of years. Customers receive a return on the amounts returned. Exh. DTE-RR-16 (Section 1.1.3(b)). In this proceeding the Company has proposed an alternative to the RVC that is equivalent in monetary terms but reflects the immediate credit to customers of the entire net proceeds from an asset sale. Exh. WM-5, p. 26. By reflecting an immediate credit to the Transition Charge, accounting for the return of the net proceeds over a period of years is eliminated. Therefore, the immediate credit method is simpler, avoids confusion and is administratively efficient. Exh. WM-5, pp. 26-27.

The Attorney General?s witness, Mr. Effron, has admitted that the immediate credit method ?should not affect the transition charge differently from the residual value credit method in any substantive way.? Exh. AG-IR-1-10. On brief, however, the Attorney General has come up with three reasons for not progressing beyond the use of an RVC. None are persuasive.

First, the Attorney General claims that use of the RVC will eliminate any problems regarding violations of ITC normalization requirements. Attorney General Brief, p. 35. This point is a part of the Attorney General?s completely discredited argument of how the Company might avoid the IRS?s ITC normalization violation rules. The existence of an RVC cannot and will not have any effect on the existence of an ITC normalization violation. The existence of an ITC normalization violation depends on the Internal Revenue Code and the Private Letter Rulings issued by the IRS. Mr. Stack testified that the key factor is the sale of the generation unit, not extraneous factors such as an RVC. See Section VII, above, for a complete discussion of the ITC.

Second, the Attorney General claims that the RVC will make it easier to observe how the Company has treated the effect of the divestiture on the Transition Charge. This is contrary to common sense. A mechanism that must be performed for many years into the future which includes calculations of carrying costs, will make it harder, not easier, to view the effect of asset divestiture. The easiest way to observe the treatment of the effect of divestiture is to have the Company give customers all their money back immediately and demonstrate how this was done. Exh. WM-5, pp. 25-26. If the Department determines that additional schedules are needed to make this determination, the Company is more than willing to provide them.

Third, the Attorney General, claims that all the other electric utilities in Massachusetts use an RVC. Attorney General Brief, p. 34. This may be correct but many elements of restructuring have changed since they were adopted. The Department should consider discrete improvements to WMECO?s, and other utilities?, restructuring plans where the change streamlines the process and where it can be verified that customers? interests are in no way harmed.

Accordingly, the Department should allow WMECO to flow back to customers the proceeds of its July 23, 1999 asset sale immediately, as reflected in WMECO?s filing.

H. WMECO WILL SUBMIT A COMPLIANCE FILING SHOWING ALL ADJUSTMENTS AND WILL REFLECT THESE ADJUSTMENTS IN FUTURE RECONCILIATION FILINGS BUT THE FINALITY OF PROCEEDINGS MUST BE HONORED.

WMECO is committed to providing the Department the information it needs in all the

Company?s proceedings, including these reconciliation proceedings. After the Department issues a decision in this matter, the Company will make a compliance filing so that all concerned can verify that all proper changes have been made. The results of that compliance filing will be tracked in subsequent filings. Exh. AG-1, p. 16.

The Attorney General, however, is proposing a method of providing data that appears to be motivated by an intent to raise issues that have been settled in one reconciliation proceeding in a later reconciliation proceeding. Attorney General Brief, p. 35. *See, also*, Subsection A.2, above. The Attorney General fails to explain what other use could be obtained from continuing to provide data for all past periods. The only rationale that the Attorney General can muster is the confusing one that the additional data ?will provide information that could be useful in assessing different potential paths for transition charge recovery in the event such differing options become available? Attorney General Brief, p. 35.

As indicated above, the Department will have a full opportunity to rule on WMECO?s compliance filing in this and in other reconciliation proceedings. Once the Department has finally ruled, however, the issues in a reconciliation proceeding are closed and cannot be reopened. The Department must make it clear that any information provided by the Company relating to finally-decided reconciliation proceedings is not properly the subject of continued inquiry.

IX. CONCLUSION

WHEREFORE, for all of the foregoing reasons, the Department of Telecommunications and Energy should approve the recovery of Western Massachusetts

Electric Company?s transition charge reconciliation costs set forth in its filing, Exh. WM-1, as amended at hearings and shown in Section IV of this brief.

Respectfully submitted,

WESTERN MASSACHUSETTS ELECTRIC COMPANY

Stephen Klionsky, Esq.
260 Franklin Street, 21st Floor
Boston, MA 02110
617/345-4778 Telephone
617/345/4780 Telecopier
klionsh@nu.com

June 12, 2001

1. Mr. Baumann is the Manager ? Revenue Requirements for Northeast Utilities Service Company (?NUSCO?), which supplies centralize ices to WMECO and other Northeast Utilities (?NU?) operating subsidiaries.

2. *See* Section VIII.A.2 for a discussion of an issue raised by the Attorney General that is not properly before the Department because it gation of a restructuring case issue.

3. A settlement is an action that eliminates an active or retired employee?s future benefits. For example, a lump sum payment to an emplo terminates his/her FAS 106 or pension benefits is a settlement. There were no settlements with the employees affected by the July 23, 1999 il/hydro sale. Tr. 1, pp. 52-54; Tr. 2, p. 248

4. Apart from these two it must be pointed out that page 9, footnote 5, of the Attorney General?s brief is, at best, misleading. It is true t has been a reduction in NUSCO employees but this is occurring now and will continue into 2002. Tr. 1, pp. 86-87. As such, that reduction, as th rney General knows, is completely irrelevant to this proceeding. The effect of the reduction to NUSCO employees, which are true settlements, wi cted in future WMECO reconciliation filings.

5. Hewitt Associates? actuarial analysis has been carried out based on the Department?s language in D.T.E. 97-120, p. 71. The actuarial ysis is not in complete compliance with accounting standards because the actuaries treated the departed WMECO employees as if they were sub ?settlement?, or a lump sum payment that settled their pension obligation. This is not the case. Thus, the actuarial analysis overstates the credi pplied to the Transition Charge compared to what may be accounted for. However, Mr. Stack testified that because the amounts at question here not material the credit did not pose a problem in this proceeding. Tr. 1, pp. 92-94.

6. Although the issue in this proceeding is the ITC as it pertains to the fossil/hydro assets sold in 1999, the same issue will arise for the I ing to the hydro and nuclear assets divested in 2000 and 2001, respectively.

7. Even Mr. Effron agrees that the IRS attempts to be consistent in issuing PLRs. Tr. 2, p. 224.

8. In some sense the issue was dealt with in the Department?s determination of deferred fuel costs

9. The manner in which the added costs were removed was through a decremental analysis, as explained by Mr. Baumann. Tr. 2, pp. 147-

10. The T-7 Off-System Sales were the subject of a correction identified by the Company, as indicated in Section II, above. Most of the nues in this category were more appropriately determined to be own-load transactions and will be credited to customers in WMECO?s complianc . Exh. DTE-RR-13.

11. It is unclear, in any case, what ?included in the transition charge? means.

12. The Department approved this divestiture in D.T.E. 99-29.

13. Inclusion of short-term debt in the Company?s capital structure is separate and independent of WMECO?s use of 1998-1999 capital cture in its rate of return calculation. See Section IV(1), above. The use of the 1998-1999 capital structure was mandated by the Department in D.T

20-A. AG-1-35.

[14] This is yet another instance in which the Attorney General has improperly raised an issue in this proceeding that either should have b
d in the restructuring case or was, in fact, raised in the restructuring case. Please refer to Subsection A.2 above, for a discussion of why the
artment should reject the relitigation of this issue.

[15] However, as also stated earlier in Section IV, any change in the Company?s method for calculating the FAS 106 obligation could elimi
double counting.